No. 86-875

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

ARTHUR ANDERSEN & CO.,

Petitioner,

—v—

MANUFACTURERS HANOVER TRUST COMPANY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT MANUFACTURERS HANOVER TRUST COMPANY IN OPPOSITION

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QUESTIONS PRESENTED

1. Should this Court exercise its supervisory powers to review unanimous determinations by the Court of Appeals for the Second Circuit that the jury procedure followed by the trial court was correct, and that in any event Petitioner waived any right to object by ignoring repeated requests from the trial court for objections?

2. Should this Court grant certiorari to review the Court of Appeals' application of settled principles of securities law to facts determined by a jury after a seven week trial?

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Respondent Manufacturers Hanover Trust Company ("MHTCo")[1] respectfully submits that the Petition of Arthur Andersen & Co. ("Andersen") for a writ of certiorari should be denied.

COUNTERSTATEMENT OF THE CASE

Background

In February 1982 Andersen misrepresented to MHTCo in a financial statement and Opinion Letter (A57-A59)[2] that Drysdale Government Securities Incorporated ("DGSI") had an opening capitalization of $20.8 million. A4-A5, A14. The

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1 Respondent's Statement pursuant to Supreme Court Rule 28.1 is set forth as the Appendix to this brief.

2 "A" refers to the Appendix to the Petition.

Opinion Letter stated that the DGSI financial statement had been examined by Andersen "in accordance with generally accepted auditing standards" and that the statement "fairly reflected" DGSI's capitalization. The Opinion Letter was sent to MHTCo to induce MHTCo to engage in repurchase and reverse repurchase agreements ("repos") on DGSI's behalf.[3] After DGSI collapsed in May 1982, it was discovered that DGSI started business with a *negative* net worth of $190 million. A4-A5.

The fraudulent DGSI financial statement and accompanying Andersen Opinion Letter were essential parts of a "Ponzi" scheme run by DGSI that resulted in more than $300 million in losses by banks that, in reliance on Andersen's fraudulent Opinion Letter, entered into repurchase and reverse repurchase agreements on DGSI's behalf. A4-A6, A8 n.4, A9 n.5.

After a seven week trial, a jury found that Andersen violated the federal securities laws by intentionally or recklessly misstating DGSI's opening capitalization. A51.

The Evidence at Trial

The evidence at trial established that Warren Essner, the senior Andersen auditing partner who prepared both the fraudulent DGSI financial statement and the Opinion Letter: (i) prepared his "audit" of DGSI without consulting any of DGSI's books or records; (ii) manufactured work papers; and (iii) violated seven separate requirements of Generally Accepted Auditing Standards and at least seven separate internal Andersen requirements for conducting an audit. A7-A9, nn. 4, 5. MHTCo also proved that Essner knew that MHTCo required an auditor's report before it would enter into repur-

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3 A repurchase agreement is the sale of a security with an agreement to repurchase the security at a later date at a fixed price. A reverse repurchase agreement is the purchase of a security with an agreement to resell the security at a later date at a fixed price. A4-A5. *See In re Bevill, Bresler & Schulman Asset Management Corp.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,966, at 94,712 (D.N.J. Oct. 23, 1986).

chase contracts on DGSI's behalf, and knew that MHTCo was relying upon the Andersen Opinion Letter to decide whether to enter into such contracts. A8, A14-A15, A17-A18.[4]

The Verdict Procedure

The jury was instructed with respect to MHTCo's federal and state law claims. After the jury returned a verdict against Andersen for $17 million, the trial court proposed to counsel that the jury state the causes of action upon which the verdict was based. A51-A53. Andersen, represented by experienced trial lawyers, made no objection. The jury left the courtroom to consider the judge's request. A52. After the jury returned and stated that it had found for MHTCo on the federal and state law claims, the court turned to counsel and asked: "Do I need to ask the jury further?" Andersen was silent. The court then asked: "Is there anything further that is needed?" Andersen remained silent. A53.

REASONS FOR DENYING THE WRIT

The Petition raises no important issues of law or policy. Andersen seeks only a review of a jury verdict that came after an error-free seven week trial which involved no significant legal issues.

I. THE COURT OF APPEALS PROPERLY HELD THAT THE VERDICT PROCEDURE WAS CORRECT AND THAT IN ANY EVENT ANDERSEN WAIVED ANY OBJECTION BY ITS REPEATED FAILURES TO OBJECT

Andersen asks this Court to use its supervisory powers to review the verdict procedure. Andersen complains, contradictorily, that either (i) the jury was allowed to provide too much

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4 On December 15, 1986, Warren Essner entered into a consent decree with the SEC arising out of his conduct in preparing the DGSI statement and Andersen Opinion Letter.

information about its verdict, *i.e.*, that Andersen violated federal and state antifraud laws, or (ii) the jury did not provide enough information about its verdict.

The Court of Appeals properly approved the verdict procedure. A28-A32. Contrary to Andersen's assertions, the trial court did not ask the jury to reconsider its findings. The jury was simply asked to enumerate the specific counts upon which it based its verdict. A26-A27.

Even if the verdict procedure had been objectionable, Andersen waived any right to object. Andersen did not take issue with any aspect of the verdict procedure, despite repeated opportunities and despite requests from the trial court for comments or objections. A10, A51-A53. This Court has consistently held that when a party, for tactical or other reasons, waives an objection, that waiver will be enforced, even in cases dealing with life or death. *See Smith v. Murray*, 106 S. Ct. 2661 (1986); *Engle v. Isaac*, 456 U.S. 107 (1982); *Wainwright v. Sykes*, 433 U.S. 72 (1977).

II. THE COURT OF APPEALS CORRECTLY APPLIED SETTLED PRINCIPLES OF SECURITIES LAW IN HOLDING THAT ANDERSEN'S FRAUD WAS "IN CONNECTION WITH" CONTRACTS TO PURCHASE OR SELL SECURITIES

The Court of Appeals affirmed the jury's verdict that Andersen's fraud was "in connection with" contracts to purchase or sell securities, and thus a violation of § 10(b) of the 1934 Securities Exchange Act, 15 U.S.C. § 78j(b), and Securities and Exchange Commission Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5. In affirming the verdict, the Court of Appeals properly applied settled principles of securities law to the particular facts of this case.

In this case and in the parallel SEC enforcement action against Warren Essner for his role in the Drysdale fraud, *SEC v. Drysdale Securities Corp.*, 785 F.2d 38 (2d Cir.), *cert. denied*

sub nom. Essner v. SEC, 106 S. Ct. 2894 (1986), the Court of Appeals held that where the very intent and purpose of a fraud is to induce the purchase or sale of a security, the fraud is "in connection with" that purchase or sale.[5] *See SEC v. Drysdale, supra* at 40-42; A11-A14, A18. As both opinions make clear, this principle is consistent with *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930 (2d Cir.), *cert. denied*, 469 U.S. 884 (1984), and with a long line of Second Circuit decisions addressing § 10(b)'s requirement that fraud be "in connection with" the purchase or sale of a security. *SEC v. Drysdale, supra*, at 40-43; A10-A13, A14, A18.

The Court of Appeals' decision is also consistent with the current Congressional understanding of the antifraud provisions of the securities laws. The House Report of the Government Securities Act of 1985 (enacted as the Government Securities Act of 1986) notes that:

> Fraud in connection with repurchase or reverse repurchase transactions, including misrepresentations concerning the financial condition of the brokerage firm effecting the transactions, is covered by the antifraud provisions of the federal securities laws. The Committee believes that the district court's decision to the contrary in *SEC v. Drysdale Securities Corp., appeal pending* No. 85-6111

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5 Both decisions applied the reasoning of *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971) in analyzing the "in connection with" requirement of § 10(b). Andersen contends that this issue was reopened in *Rubin v. United States*, 449 U.S. 424 (1981). In fact, *Rubin* dealt only with whether a pledge of a security as collateral for a loan is a sale for purposes of § 17(a) of the 1933 Act (15 U.S.C. § 77q). The comment in footnote 6 of *Rubin* merely states that this Court was not automatically extending the scope of the securities laws to cover every conventional bank loan that might be secured in part by a pledge of securities. *Rubin* did not purport to limit *Superintendent of Insurance*, and *Rubin* has not been construed as doing so. *See Angelastro v. Prudential-Bache Securities, Inc.*, 764 F.2d 939, 946 (3d Cir.), *cert. denied*, 106 S. Ct. 267 (1985); *Chemical Bank v. Arthur Andersen & Co., supra*, 726 F.2d at 944.

> (2d Cir.) [*reversed*, 785 F.2d 38 (2d Cir.), *cert. denied sub nom. Essner v. SEC*, 106 S.Ct. 2894 (1986)], is incorrect.

H.R. Rep. No. 258, 99th Cong., 1st Sess. 17 n.22 (1985).

The Court of Appeals properly applied this well-established principle both in this case and in reversing the district court decision in *SEC v. Drysdale*. The purpose and intent of Andersen's fraud was to cause the banks to enter into contracts to buy securities at a set price, and into contracts to deliver securities at a set price. When DGSI collapsed, those contracts were binding on the banks. A20.

Thus, unlike the situation in *Chemical Bank v. Arthur Andersen & Co., supra*, 726 F.2d at 944 n.24, this is not a case where the fraud relates only incidentally or fortuitously to a securities transaction. The sole purpose of Andersen's fraud was to induce banks such as MHTCo to enter into contracts to purchase and sell securities. Andersen's fraud thus directly and intentionally "touched" the securities transactions in this case, easily meeting the test set forth by this Court in *Superintendent of Insurance, supra*, 404 U.S. at 12-13.

Andersen claims, however, that the Court of Appeals erred in holding that Andersen's fraud was a violation of the securities laws, because the trial court charged the jury that repos were securities. Andersen argues that this charge was error, and that a jury finding that Andersen's fraud was "in connection with" repos does not support a verdict that Andersen violated § 10(b).

The Court of Appeals, however, recognized that it did not have to determine if the repos in this case were securities, since Andersen's fraud in connection with repurchase agreements was itself a violation of § 10(b). A13-A14. This was not a new or radical expansion of the law by the Court of Appeals. It was the logical application of the definition of "purchase or sale" in the Exchange Act.

The Exchange Act states that "purchase or sale" includes "contract[s] to buy, purchase or otherwise acquire securities."

15 U.S.C. § 78c(a)(13). Since repurchase and reverse repurchase agreements are contracts to purchase or sell securities (A12), § 10(b)'s prohibition against fraud in connection with the purchase of securities also bars fraud in connection with repurchase agreements.[6] This conclusion is not new. *See* Securities Act Release No. 33-6351, 1 Fed. Sec. L. Rep. (CCH) ¶ 2024, at 2559-2 (Sept. 25, 1981). The SEC urged it in its *amicus* brief below. A13 n.6. The application of § 10(b) to the facts of this case hardly warrants this Court's plenary review.

CONCLUSION

The Petition for a writ of certiorari should be denied.

Respectfully submitted,

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6 The logical steps followed by the Court of Appeals are simple and obvious:

— a "purchase of a security" includes a contract to purchase a security;

— a repurchase agreement is a contract to purchase a security;

— therefore, § 10(b) bars fraud in connection with a repurchase agreement.

APPENDIX

RULE 28.1 LISTING

The parent company of Respondent Manufacturers Hanover Trust Company is Manufacturers Hanover Corporation.

The subsidiaries (except wholly owned subsidiaries) and affiliates of Manufacturers Hanover Trust Company are: Manufacturers Hanover Leasing S.p.A.; Arrendadora Bancomer, S.A. de C.V.; P.T. Manufacturers Hanover Leasing Indonesia; Manufacturers Hanover de Arrendamiento Financiero S.A.; Korea Industrial Leasing Co., Ltd.; Manufacturers Hanover Leasing S.p.A.; and CSW Leasing, Inc.